DIRECTOR-GENERAL OF INLAND REVENUE v. L.T.S.

[A.C.J. (Chang Min Tat J.) April 25, 1974]
[Penang — Originating Motion No. 19 of 1973]

Income Tax — Outgoings and expense wholly and exclusively incurred in the production of income — Taxpayer transferee of permit holders for extraction of timber — Whether purported assignment of permit illegal and unenforceable — Royalties paid to State Government for extraction of timber — Commission for user of permits — Whether deductible — Income Tax Act, 1967, ss. 33 and 39.

In this case the taxpayer was a transferee of the permit holders for the extraction of timber. The questions which arose were whether —

(a) sums paid to the Government of Kedah as royalties for the extraction of timber;

(b) sums paid as commissions for the user of the permits, were deductible as being "outgoings or expenses wholly and exclusively incurred" by the taxpayer in the production of his gross income

Held: (1) although the purported assignments of the permits were illegal and unenforceable, the income of the taxpayer from the illegal source was liable to tax and the taxpayer was entitled to the deductions properly allowed by the Income Tax Act;

(2) the sums paid to the Government of Kedah in respect of royalties was deductible as outgoings and expenses wholly and exclusively incurred for the production of the income under section 33(1) of the Income Tax Act, 1967;

(3) the commission paid to the permit holders was however not deductible as it was caught by sub-section 1(g) of section 39.

Cases referred to:-

(1) *Leong Poh Chin* v. *Chin Thin Sin* [1959] M.L.J. 246.

(2) *Tan Bing Hock* v. *Abu Samah* [1967] 2 M.L.J. 148.

(3) *Lo Su Tsoon Timber Depot* v. *Southern Estate Sdn. Bhd.* [1971] 2 M.L.J. 161.

(4) *Minister of Finance* v. *Smith* [1927] A.C. 193 at p. 197.

(5) *Ralli Estates Ltd.* v. *Income Tax Commissioner* [1961] 1 W.L.R. 329 at p. 335.

ORIGINATING MOTION.

Mohamad Haji Said (Senior Federal Counsel) for the appellant.

Tan Phock Kin for the respondent.

Chang Min Tat J.: This is a case stated by Revenue on appeal from the decision of the Special Commissioners of Income Tax allowing in respect of the year of assessment 1970:

(1) the sums of $36,600 and $42,000 paid to the Government of Kedah as royalties for the extraction of timber under certain permits (hereinafter called the royalties), and

(2) the sum of $5,586 paid as commissions for the user of the permits (hereinafter referred to as the commissions)

as "outgoings or expenses wholly and exclusively incurred" by the taxpayer in the production of his gross income from that source within the scope of section 33(1)(a)(i) of the Income Tax Act 1967.

The main difficulty encountered in the determination of this case arose from the fact, particularly in the case of the royalties, that the taxpayer was not the concessionaire but only a transferee of the permit-holders by assignments which were in clear breach of the very first clause of the permits. This clause prohibited the transfer by the permit-holder of any of his rights, obligations or liabilities under the permit to any other person or persons by power of attorney or in any other manner, except with the permission in writing of the State Forest Officer. The prohibition was expressed to be a condition of each permit. The permit itself was made out to the holder personally and the felling of the timber was to be permitted to him his agents or employees. Since, by any rule of construction, an agent cannot include an assignee or a transferee, and since no consent of the State Forest Officer was applied for or obtained, the transfers to the taxpayer were clearly in breach of this condition.

It was seriously contended by Revenue at all stages that the transfer of the permits to the taxpayer was an illegal transaction. The point made was that in view of the illegality of the contracts between the permit-holders and the taxpayer, no deduction should be allowed for the payments of the royalties and commissions, as otherwise the department and the court would be "enforcing" illegal contracts. Revenue was prepared to concede that the royalties if paid by the permit-holders to the Government would be deductible as expenses under section 33(1)(a)(i) of the Act, but contended that this deduction did not and could not extend to any person under the illegal contracts.

Learned Federal Counsel for Revenue before the Special Commissioners relied on the case of *Leong Poh Chin* v. *Chin Thin Sin*[1] in which Good J. (as he then was) held that the transfer of a forest permit issued under the Forest Enactment (F.M.S. Cap. 153) with a similar prohibition against assignment was a breach of the provisions of the Enactment and an illegality.

This case notwithstanding, the Special Commissioners, on this point, were of the opinion that "Although the agreements may not be valid as against the Government of Kedah, they were not illegal as between the respondent (taxpayer) and the two permit-holders." No reasoning was advanced for this conclusion.

Before me, learned Federal Counsel cited two other cases, *Tan Bing Hock* v. *Abu Samah*[2] and *Lo Su Tsoon Timber Depot* v. *Southern Estate Sdn. Bhd.*,[3] the latter being a decision of the Federal Court of Malaysia. Both cases were decisions on similar provisions of comparable legislation and both held in no uncertain terms that the purported assignments in breach of the regulations and conditions of the permits were illegal and unenforceable.

With the greatest of respect, I do not accept the opinion of the Special Commissioners as correct. I am of course bound by the decision of the Federal Court, but with respect, would make bold to say that I agree entirely with the decisions in both cases. There can, in my view, be no doubt about the illegality of the transactions, which must be considered, whether viewed in their relation with Government or inter-partes as being in breach of a clear provision of law, and therefore tainted with illegality. Government was at all times able to prevent the transferee from exercising his rights under the illegal or as the Special Commissioners would have it, the invalid agreements and would in all possibility be justified in treating him as a trespasser on Government lands. Inter-partes, neither party would be able to come to court to enlist its help

to seek enforcement of the contracts or any of their provisions. Clearly, what the law forbids, it does not allow.

On the other hand, it is, with respect, not entirely right to hold that to consider the payments made by the transferee-taxpayer under the illegal contracts deductible under the Income Tax Act would be to give consideration to and to entertain or enforce such illegal or unenforceable contracts.

Revenue did not contend that the taxpayer did not need to pay income tax on moneys derived from an illegal source. Revenue however contended that outgoings from such moneys could not be treated as such, even within the meaning of expenses wholly and exclusively incurred in the Act. But as was said in the Privy Council in the judgment of Their Lordships in *Minister of Finance* v. *Smith*[4] at page 197:

"There is nothing in the Act which points to any intention to curtail the statutory definition of income, and it does not appear appropriate under the circumstances to import any assumed moral or ethical standard, as controlling in a case such as this the literal interpretation of the language employed."

The statutory definition of chargeable income within the Act is the gross income adjusted to allow for such deductions as are properly allowed by the Act.

Basically it is therefore a matter of strict construction of a taxing statute and it is for Revenue and for the court on appeal to consider whether the deduction sought in an assessment of the income chargeable to tax is or is not within the provisions of the Act. More specifically, as is provided in section 5(1) of the Act, the chargeable income of a person is ascertained under sub-sub-section (a) for the basis period, sub-sub-section (b) on his gross income from each source, sub-sub-section (c) with such adjustments thereof as are allowable under Chapter 4 of Part II of the Act. Sub-sub-sections (d), (e) and (f) of section 5 subsection (1) are not relevant to this case. Needless to say, section 33, referred to earlier and section 39 which was also considered by the Special Commissioners, are in this Chapter 4.

But though this determination must be on the basis of the interpretation of the Act, it involves, in the terms of the Act's predecessor, the distinction between capital and revenue expenditure, the latter being deductible and the former, not. In modern form, the question to be decided is whether the expenditure was an outgoing or expenses "wholly and exclusively incurred during that period by that person in the production of gross income from that source," in section 33 as qualified within set limits by section 39.

In respect of the royalties paid to Government, the answer is fairly simple. If I remind myself that the assessment of the chargeable income of any person is to be determined within the four corners of the statute, I must, as Their Lordships of the Privy Council did in *Ralli Estates Ltd.* v. *Income Tax Commissioner*[5] at page 335:

"... turn back to the words of the Act and ask whether the payments were expenses wholly and exclusively incurred 'in the production of the income' of the payer: and this means that you must look at the purpose of the payments. Were they paid in order to acquire a capital asset? or for a capital purpose? If so, they are capital expenditure. But if for an income purpose, they are revenue expenditure. For instance, if a price is paid for freehold land, or a premium (properly so called) is paid for a long lease, it is not an expense incurred in the production of income, but in the production of capital. It is not deductible as revenue expenditure, no matter whether the price or premium is paid by a lump sum or by instalments. And this is true even when the lease is of a wasting asset, such as a coal mine, see *Mallett* v. *Staveley Coat and Iron Co. Ltd.* by Rowlatt J. Again, if a manufacturer expends money on machinery or plant which is used again and again in his manufacturing operations, it is capital expenditure, and is not deductible in assessing his income, no matter whether he pays for it cash down or by instalments. But if a trader pays money for trading stock which he means to sell to customers as soon as he can, it is an expense incurred in the production of income, no matter whether it is paid in a lump sum or by instalments: and it is deductible. Likewise with a rent, properly so called, which is paid for a lease out of which the lessee gets an income. It is a revenue expenditure and deductible."

On the concession of Revenue which if I may say with respect, is in my opinion entirely correct, the royalties are clearly outgoings and expenses wholly and exclusively incurred within section 33(1) of the Act and therefore allowable as deductions.

The matter of the commissions paid by the taxpayer to the permit-holders is perhaps a little more difficult in the absence of any concession by Revenue. It involves the interpretation of section 39 read, as it must be, in conjunction with section 33. This section reads, in its pertinent parts,

S.39(1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment, no deduction from the gross income from that source for that period shall be allowed in respect of:—

(e) any expenditure incurred in relation to a business, being expenditure which is—

(ii) ... or qualifying forest expenditure for the purposes of Schedule 3; or

(iii) ... and which but for this paragraph would be deductible in ascertaining the adjusted income from the business;

(g) any sum, by whatever name called, payable (otherwise than to a State Government) for the use of a licence or permit to extract timber from a forest in Malaysia.

(2) It is hereby declared that section 33 except in so far as it relates to expenses of the kind specified in sub-section (1)(a) to (d), is not an express provision of this Act within the meaning of this section.

In their Deciding Order, the Special Commissioners held the commissions to be expenses wholly and exclusively incurred under section 33(1) of the Act. They made no mention of section 39. In their grounds of decision, however, they did consider section 39 but only to dismiss the interpretation contended by Revenue and only in connection with the royalties, as it would appear. They held that —

"Section 39(2) does not declare the whole of section 33 as being an express provision of the Act within the meaning of the opening words of section 39 because section 39(2) has specifically made exceptions with regard to sub-section (1)(a) to (d) of section 33. Our view of the interpretation of section 39(2) however did not affect the position of the respondent in respect of the royalties that he had paid because we had, as stated in the preceding paragraph, decided that section 39(1)(g) of the Income Tax Act 1967 was applicable to the respondent's case."

With the greatest respect, I find some difficulty in fully comprehending the meaning and the logic of the view taken by the Special Commissioners. Section 39 refers to deductions that are not allowed. Subsection (1) specifies such deductions. They include in subsection (g) any sum payable otherwise than to a State

Government for the use of a licence or permit. Subsection (2) must with respect mean that the deductions allowed in section 33 as expenses wholly and exclusively incurred do not extend to the expenditure mentioned in sub-sub-sections 39(1)(a) to (g).

It therefore means that the sum paid by the taxpayer to the permit-holders is caught by subsection (1)(g) of section 39 and is not deductible.

It also means that the sum paid to the Government of the State of Kedah in respect of the royalties is deductible under the relief provided in "otherwise than to a State Government" in this subsection, as rightly conceded by Revenue.

To conclude, I need only to point to the "qualifying forest expenditure for the purposes of Schedule 3" in section 39(1)(e)(ii) above as defined in paragraph 8 of Schedule 3 which though ordinarily excluded as a deduction by sub-section 39(2) is by the saving provision in sub-section 39(2) itself and by sub-sub-section 33(1)(d) partially allowed as a deduction. The scope of the deduction is set by paragraphs 28-30A of the said Schedule 3. It does not include any commissions paid for the use of the licence.

The appeal of Revenue is therefore allowed to the extent that the decision of the appellant to treat the commissions paid by the taxpayer to the permit-holders as not deductible in arriving at his adjusted income is restored.

Appeal allowed in part.

Solicitors: *Thillaimuthu & Phock Kin.*

OSMAN BIN MAT ISA & ORS. v. SUPERINTENDENT OF PRISON, ALOR STAR & ANOR.

[O.C.J. (Chang Min Tat J.) April 27, 1974]
[Penang — Kedah Originating Motion No. 25 of 1973 and Penang Originating Motions Nos. 10, 13 & 14 of 1973]

Criminal Law and Procedure — Habeas Corpus — Successful application — Whether applicant entitled to costs — Criminal Procedure Code (Cap. 6), ss. 99-102, 258, 322 and 365 — Criminal Procedure Code (SS. Cap. 21), ss. 109-112, 251, 316, 387 and 456.

In these cases applications had been made for orders of *habeas corpus*. One of the applications was successful but the others were not. The question arose whether costs were payable to the successful applicant or to the Government.

Held: there could be no order as to costs under the Criminal Procedure Code in these applications and there were no exceptional circumstances to justify a departure from the general rule.

Cases referred to:-

(1) *Lee Mau Seng* v. *Minister of Home Affairs, Singapore & Anor.* [1971] 2 M.L.J. 137.
(2) *Lau Lek Eng & Ors.* v. *Minister for Home Affairs, Singapore & Anor.* [1972] 2 M.L.J. 4.
(3) *Wee Toon Lip & Ors.* v. *Minister for Home Affairs, Singapore & Anor.* [1972] 2 M.L.J. 46.
(4) *Lim Hock Siew & Ors.* v. *Minister of the Interior and Defence, Singapore* [1968] 2 M.L.J. 218.
(5) *Munusamy* v. *Subramaniam & Ors.* [1969] 2 M.L.J. 108.
(6) *Ex parte Johanns Choeldi* [1960] M.L.J. 184.
(7) *Aminah* v. *Superintendent of Prisons, Pengkalan Chipa, Kelantan* [1968] 1 M.L.J. 92.
(8) *Karam Singh* v. *Menteri Hal Ehwal Dalam Negeri* [1969] 2 M.L.J. 129.
(9) *Assa Singh* v. *Menteri Besar, Johor* [1969] 2 M.L.J. 30.
(10) *Amand* v. *Home Secretary and Minister of Defence of Royal Netherlands Government* [1943] A.C. 142.
(11) *R.* v. *Johnson* [1904] A.C. 817.

ORIGINATING MOTIONS.

Karpal Singh for the applicant.

Abu Talib bin Othman (Legal Adviser, Penang) for the respondent.

Chang Min Tat J.: An application has been made for costs in the one application out of four applications for orders of *Habeas Corpus* in which the applicant was successful.

If costs follow the event, then there was 1 set of costs against 3 sets for Government. Nevertheless despite what must or could be self-cancelling orders, Mr. Karpal Singh presses me for an answer.

In Kedah Originating Motion No. 25/73, one Osman bin Mat Isa made an application against the Superintendent of Prison, Alor Star. This was heard by me on 4 August 1973. Mr. Karpal Singh applied for an adjournment. On the resumed date of hearing, he withdrew his application intimating that he would make a fresh application. The learned Legal Adviser asked for costs but Mr. Karpal Singh resisted. I reserved the question of costs.

True to his word, Osman bin Mat Isa did make a new application, but in his wife's name. The application Penang Originating Motion No. 10/73 was filed in Penang. On 15 August 1973, I held that *ex facie* there was some doubt whether the order of detention as served was made in the intention of the Home Minister and ordered the release of Osman bin Mat Isa. The question of costs was also reserved.

Next, in Penang Originating Motion No. 13/73, one Che Su binte Shafie made an application for an order of *Habeas Corpus* in respect of one detainee Awang bin Monei @ Awang Mona and in Penang Originating Motion No. 14/73 filed on the same day, one Siti Aminah binte Abdullah made a similar application for Osman bin Hussin @ Man Merang @ Man Kerbau. Mr. Karpal Singh appeared for both applicants.

An order was made in each case on 24 August 1973 for an order nisi to issue and on the return date which was 30 August 1973, cause being shown, the order nisi was discharged. This meant that the applications failed.

Arguments for costs in Originating Motion No. 10/73 in which the applicant succeeded were heard on 12 December 1973. It was the contention of Mr. Karpal Singh that the applicant was entitled to costs as of right. For myself I have always thought that costs are a matter of discretion but since in the absence of any circumstances justifying an order to the contrary, costs normally follow the event and the court's discretion must always be exercised judicially, the contention of Mr. Karpal Singh was not, with respect, as startling as it sounded. However, he further argued that the question of costs in the other cases was within the discretion of the court but suggested that the discretion should be exercised in favour of his clients.